

*This document is originally from the Subcommittee on Corporate Governance meeting of January 5, 2001*

TEACHERS' RETIREMENT BOARD

SUBCOMMITTEE ON CORPORATE GOVERNANCE

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SUBJECT: Securities Litigation Policy

ITEM NUMBER: 4

ATTACHMENT(S): 4

ACTION: X

DATE OF MEETING: January 5, 2000

INFORMATION: \_\_\_\_\_

PRESENTER(S): Mr. Waddell

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Attached for the Subcommittee's consideration is a draft policy for CalSTRS' involvement in securities litigation matters (Attachment 1). If approved, it will be substituted for existing Section B (4) (d) of the Corporate Governance Policy (Attachment 2). Also included for the Subcommittee's reference is the shareholder litigation item that was presented to on September 1, 1999 (Attachment 3).

While much of the attached policy is self-explanatory, several items require elaboration, as follows.

***Goal and Objectives of Policy:*** Staff believed that it was important to set forth at the outset the purpose for the System's involvement in this area. The identified goal is to enhance the long-term value of the CalSTRS portfolio, consistent with the Investment Management Plan of the System. The objectives that contribute towards meeting that goal consist of: 1) increasing the dollar value of a settlement in a given case over what might be obtained absent CalSTRS' involvement; 2) increasing the long-term value of an ongoing CalSTRS' asset, most likely through corporate governance reforms obtained as a result of a class action settlement; 3 and deterring wrongful corporate conduct. Staff believes that if active CalSTRS involvement in a particular case does not provide the opportunity to fulfill at least one of these objectives, such involvement should not be undertaken in that case.

***Criteria for Seeking Lead Plaintiff Status:*** The proposed policy identifies a threshold potential damages amount of \$5 million for seeking lead plaintiff status except for those cases where there are strong alternative grounds, including cases where there is an exceptional opportunity to preserve or enhance the long-term value of a significant portfolio holding or to deter wrongful

corporate conduct. The \$5 million amount, calculated by looking at purchases of target company shares during the class period net of sales during the same period, represents an attempt to identify that amount where active CalSTRS involvement could make a material financial difference to its portfolio. The Subcommittee will recall from the earlier presentation on this subject that the average settlement in a securities class action case recovers approximately 10-14% of total damages. As such, in a hypothetical case where CalSTRS' total damages are \$5 million, the average recovery if CalSTRS were to remain a passive class participant would be \$500,000 to \$540,000. If, through CalSTRS' active participation, the settlement recovery was improved to 25% of total damages or \$1.25 million, the net increase to CalSTRS would be \$710,000 to \$750,000.

Based on the above, staff believes that \$5 million represents the appropriate threshold that should be considered for seeking lead plaintiff status based solely on the objective of maximizing the economic return of that case. However, staff has included alternative criteria based upon corporate governance/deterrence considerations in order to provide the System with the flexibility to consider involvement in appropriate cases that do not satisfy the dollar threshold.

***Evaluation of Cases for Potential Lead Plaintiff Status:*** If staff determines on a preliminary basis that seeking lead plaintiff status should be proposed to the Subcommittee/Committee, under the draft policy the case would be referred to outside counsel for evaluation. It is contemplated that this evaluation would include an analysis of the strengths and weaknesses of the case, the recoverable damages, and the advantages and disadvantages to CalSTRS of becoming lead plaintiff in the particular case. Such counsel would be identified in advance through a competitive process and compensated on an hourly or flat fee basis. To ensure their objectivity, such counsel would not be eligible to serve as class counsel in that case if CalSTRS is selected as lead plaintiff; but for reasons noted below such counsel would file and argue the initial motion for CalSTRS to be named lead plaintiff.

***Selection of Lead Counsel:*** As was observed in the September presentation on this subject, the selection of lead plaintiff in securities class action litigation has often been a very contentious process, and at times has led to bitter disputes between institutional investors. Staff believes that much of the "heat" in these disputes can be traced to the underlying issue of selection of lead counsel. Typically, individuals and institutions seeking lead plaintiff status have pre-selected the counsel that would serve as lead counsel if they were selected as lead plaintiff. This creates an incentive for counsel for each moving party to attack the other parties, since loss of the lead plaintiff motion likely also means the loss of the opportunity to serve as lead counsel.

Staff believes that CalSTRS should pursue a different approach. Under the proposed policy, evaluation counsel would also file and argue the motion for designation as lead plaintiff. However, instead of going on to serve as lead class counsel if CalSTRS were named as lead plaintiff, the firm would be ineligible to serve in this capacity in that case. Instead, immediately after designation by the Court as lead plaintiff, CalSTRS would complete an expedited competitive process for the selection of lead class counsel. Although it would involve some up-front expenditure by CalSTRS, staff sees the following advantages in

this approach. First, it avoids locking the System into a counsel and fee relationship early in the process when it may be

difficult to determine whom the most appropriate lead class counsel is and what the most appropriate fee agreement may be. Second, it eliminates the incentive for counsel for other movements for lead plaintiff status to attack CalSTRS during that process, since all such counsel would be potential contestants for lead counsel if CalSTRS was selected by the Court as lead plaintiff. Third, staff believes that a competitive process conducted by CalSTRS *after* being selected as lead plaintiff will yield the most cost-effective fee arrangements and enhance the likelihood of Court approval of lead counsel.

***Alternatives to Seeking Lead Plaintiff Status:*** The proposed policy identifies both litigation and non-litigation alternatives to seeking lead plaintiff status in securities class action litigation. These alternatives were previously identified to the Subcommittee during the September presentation.

***Authority to Approve CalSTRS Involvement:*** Under the proposed policy, seeking lead plaintiff status and pursuing other litigation alternatives that would either place CalSTRS in a leadership position with respect to litigation or would involve a significant expenditure of funds or System resources would require the approval of the Subcommittee and the Investment Committee. Conversely, other litigation alternatives such as filing briefs or motions with the Court concerning particular aspects of a case in which CalSTRS is interested or participation in settlement negotiations in a case (where CalSTRS is not a lead plaintiff) would not require Subcommittee or Committee approval, although such activities would be regularly reported upon. Non-litigation alternatives that are supplemental to CalSTRS' participation as a passive class member would not require approval unless such approval was otherwise required under existing Board policy (e.g., pursuit of shareholder proposals or similar corporate governance activities).

***Staff Recommendation:*** Adopt the proposed shareholder litigation policy and incorporate it into the Corporate Governance Policy.